

UNITED NATIONS



NATIONS UNIES


POSTAL ADDRESS—ADRESSE POSTALE: UNITED NATIONS, N.Y. 10017  
CABLE ADDRESS—ADRESSE TELEGRAPHIQUE: UNATIONS NEWYORK

REFERENCE:

AUD-7-5: 54 ( 1130 /99)

21 July 1999

To: Mr. Benon Sevan, Executive Director  
Office of Iraq Programme

From: Esther Stern, Director   
Audit and Management Consulting Division, OIOS

Subject: Audit of a contract for the supply of inspection agents in Iraq  
under the Oil for Food Programme (AP1998/17)

1. I am pleased to transmit the final report on the subject audit. The report summarizes the findings and recommendations resulting from audit observations by the then OIOS Resident Auditor posted in the United Nations Office of the Humanitarian Coordinator for Iraq (UNOCHI) and further review of contract amendments and extensions at Headquarters. It also contains comments received from the Office of Iraq Programme and the contractor.

2. When commenting on the recommendations in the report, please refer to the recommendation number concerned to facilitate monitoring of their implementation status. I would appreciate receiving your reply by 21 August 1999.

3. I would like to thank you and the Office of Iraq Programme staff for the cooperation and assistance extended to the auditor.

cc: UN Board of Auditors  
Planning and Compliance Officer, OIOS  
Mr. Prendergast  
Mr. Connor  
Mr. Niwa



**UNITED NATIONS  
OFFICE OF INTERNAL OVERSIGHT SERVICES  
AUDIT AND MANAGEMENT CONSULTING DIVISION**

**Audit Assignment No: AP1998/17**

**21 July 1999**

**Report on a contract for the supply of inspection agents in Iraq  
under the Oil for Food Programme**

**Auditor-in-Charge**

**Raja P.Arumugham**

**Report on a contract for the supply of inspection agents in Iraq  
under Oil for Food Programme**

**EXECUTIVE SUMMARY**

UN Headquarters contracted for the supply of 32 inspection agents (agents) and a manager, at a cost of \$4.5 million, to undertake monitoring, verification, inspection and testing of humanitarian supplies imported into Iraq at three entry points. The contractor was required to supply the services of the agents for a period of six months. The contract came into effect on 6 December 1996. The proposal received from the contractor was not the lowest bid.

Through five contract amendments, the contract period was extended by 19 months. Two of the amendments required the contractor to supply a total of 22 additional agents. As a result of the six amendments the value of the contract was increased from \$4.5 million to \$25.18 million.

The OIOS Resident Auditor posted in the United Nations Office of the Humanitarian Coordinator for Iraq (UNOHCI) in Baghdad issued two audit observations as a result of a review of the management of the contract. This report summarizes the audit findings and recommendations resulting from the audit observations, responses received from the Office of Iraq Programme (OIP) and the contractor and further review of contract amendments and extensions at Headquarters.

The review revealed the following:

- The contractor was required to supply a specified number of agents at each designated site on a twenty-four hour, seven-day basis at a rate of about \$770 per agent day. However, the contractor's invoices included a substantial number of days – some 1,800 days, according to OIOS estimates – during which the agents were physically not at their designated sites, but were instead travelling to or from those sites. OIOS estimates that, as a result, the United Nations has been overcharged approximately \$1.38 million. OIP should recover the overpayments from the contractor.
- The contractor's invoices were received and certified for payment by Headquarters on the basis of documentation provided by the contractor. No on-site verification was performed to determine that the contractor had delivered the services as contracted or invoiced.
- The initial complement of 32 agents were deployed in full by the end of December 1996, whereas the first contracts for the import of humanitarian supplies were only issued in January 1997 and the first shipments did not arrive until late March 1997. The contractor without consultation took the decision to deploy all the agents even though DPA had requested that it be done in stages. A substantial portion of the first three months' expenditure amounting to about \$1.97 million could have been avoided.

- The need for 10 additional agents at the fourth import point was based on a report of a Customs expert. However, the need does not appear to have been determined properly.
- Additional services amounting to \$20.87 million were contracted on the basis of the initial \$4.5 million contract. While recommending the approval of each amendment, the Headquarters Contracts Committee (HCC) had recommended and/or reiterated that considerations be given to soliciting new bids for the services. Although the Procurement Division (PD) had followed-up on the recommendation and asked DPA to submit its specifications for the services as early as September 1997, DPA and subsequently OIP did not initiate action to solicit new bids until mid-1998.
- Requests for contract extensions were submitted to the Procurement Division not long before the contract was due to expire. Given the critical nature of the service and the contractor's familiarity with internal processes, the Procurement Division did not have much leverage to negotiate the most favourable terms for the Organization. The Headquarters Contracts Committee (HCC) too had to deal with a 'fait accompli' situation. Consequently the intent of the procurement regulations and procedures was in substance negated in this case.
- The contract rate of \$770 per agent day was justified on the basis of the need to recover high initial fixed costs within the contract period of six months. Although the fixed cost element should have reduced with each contract extension, this rate continued to be used for all contract extensions.
- Although assertions were made to the HCC that the contractor's performance was satisfactory, the Auditor noted instances of deficiencies in the performance of the contractor, some of which could have serious implications for the United Nations. OIP has stated that action will be taken to address these issues in the management of the current contract.

## **TABLE OF CONTENTS**

<b><u>Section</u></b>	<b>Paragraph</b>
<b>I. INTRODUCTION</b>	<b>1 - 4</b>
<b>II. BACKGROUND</b>	
<b>Contract provisions</b>	<b>5</b>
<b>Contract amendments for the supply of additional agents</b>	<b>6 - 8</b>
<b>Contract extensions</b>	<b>9</b>
<b>III. AUDIT FINDINGS AND RECOMMENDATION</b>	
<b>A. Premature deployment of agents</b>	<b>10 - 12</b>
<b>B. Need for additional 10 inspectors – not properly determined</b>	<b>13 - 15</b>
<b>C. Extensions of contract could have been avoided and significant amount of costs saved</b>	<b>16 - 25</b>
<b>D. Possible overpayments to Lloyds of about \$1.38 million</b>	<b>26 - 40</b>
<b>E. Other deficiencies in contractor's performance</b>	<b>41 - 42</b>
<b>F. Recommendations</b>	<b>43</b>
<b>IV Acknowledgements</b>	<b>44</b>

## **I. INTRODUCTION**

1. The UN Headquarters contracted with Lloyd's Register Inspection Ltd. (Lloyd's) for the supply of 32 inspection agents (agents) and a manager for a period of six months at a total cost of \$4.5 million. The agents were required to monitor, verify, inspect, test and authenticate humanitarian supplies imported into Iraq at three entry points under the 'food for oil programme'. Although the proposal submitted by Lloyd's was not the lowest bid, it was awarded the contract on the grounds of reliability, with the recommendation of the Headquarters Contract Committee.
2. The contract with Lloyd's was extended five times for periods totaling approximately 19 months and Lloyd's was also required to supply additional agents. As a result of these extensions and additional requirements the original value of the contract was increased by \$20.87 million to \$25.37 million.
3. The OIOS Resident Auditor (Auditor), based in the United Nations Office of the Humanitarian Coordinator for Iraq (UNOHCI) in Baghdad, reviewed the management of the contract and submitted various observations to UNOHCI. As the contract was directly managed by Headquarters, the audit observations were forwarded to the Office of Iraq Programme (OIP) for comments and action.
4. This report summarizes the audit findings and recommendations resulting from the audit observations, responses received from OIP and the contractor and further review of contract amendments and extensions at Headquarters. The review, however, did not include the award of the initial contract.

## **II. BACKGROUND**

### **Contract provisions**

5. Under the provisions of the contract:
  - (i) Lloyd's was required to provide the services of a manager and 32 agents at three import entry points in Iraq on a twenty-four hour, seven-day week basis;
  - (ii) The UN reserved the right to increase or decrease the number of agents at any time;
  - (iii) The contract price included all costs relating to the service, including without limitation, all salaries, benefits, insurance, board, lodging, communications equipment, transmission costs, security, transportation and other equipment; and
  - (iv) Any increase or decrease in the number of agents by more than six persons was to be compensated at \$529 per person per day.

### **Contract amendments for the supply of additional agents**

6. In August 1997, the UN decided to open a fourth import entry point and asked the contractor to supply 10 additional agents at the \$529 per agent day rate, provided in the contract. However, Lloyd's contended that the rate of \$529 only applied to the existing three import points and instead requested compensation at the rate of \$1,275 per agent day for the new site. Lloyd's contended that the higher rate was necessary to recoup fixed costs over a period of time. After negotiations with the Procurement Division (PD), the contractor agreed to the per agent day rate of \$770, subject to the contract being extended for a further period of three months to March 1998.

7. As a result of the expected increase in imports, in May 1998 OIP requested the deployment of 12 additional agents commencing in July 1998. Again Lloyd's requested a compensation of \$770 per agent day for the additional agents and additional compensation for new equipment and the upgrade of existing facilities. After negotiations with the PD, Lloyd's agreed to supply 4 agents at a rate of \$543 per agent day and 8 inspectors at \$770 per agent day together with an additional UN guarantee that costs of certain equipment would be reimbursed should the contract be prematurely terminated.

8. The HCC reviewed and approved both proposals for the supply of additional agents together with related contract extensions mentioned in paragraph 9 below.

### **Contract extensions and increase in contract amount by \$20.87 million**

9. The initial contract amounting to \$4.5 million was for the supply of agents for a period of six months from 4 December 1996 to 4 June 1997. The contract was extended up to the end of January 1999 through five contract amendments at the request of the Department of Political Affairs (DPA), which was initially responsible for the function, and subsequently the OIP as shown in the following table:

Amendments	Date requested by DPA/OIP	Presented for HCC Approval	Contract extended for period		Addition to contract sum US \$
			From	To	
1	15/05/97	20/05/97	06/06/97	05/12/97	4,500,000
2 *	18/08/97	08/09/97	06/12/97	05/03/98	3,611,000
3	17/02/98	25/02/98	05/03/98	30/06/98	3,783,780
4 *	22/05/98	30/06/98	01/07/98	31/12/98	7,751,923
5	03/12/98	08/12/98	01/01/99	30/01/99	1,220,160
Total addition to initial contract sum					20,866,863

\* Note: Contract amendments 2 and 4 included the supply of additional agents mentioned in paragraphs 6 and 7 above.



## **II. AUDIT FINDINGS AND RECOMMENDATIONS**

### **A. Premature deployment of agents**

10. DPA in a letter dated 4 December 1996 requested Lloyd's to mobilize an initial contingent of 12 agents and the remaining 20 agents to be mobilized and deployed later as the operation progressed. However, the contractor mobilized and deployed all the agents in December 1996 itself. The first contract for supplies under the food for oil programme was only approved in late January 1997 and the first consignment of supplies did not arrive in Iraq until the end of March 1997. As a result, the agents were idle for almost three months. DPA appears to have accepted the unilateral decision of the contractor to deploy all agents as early as December 1996.

11. *OIP explained that: (i) because the programme was a wholly new venture for the United Nations, it was considered unwise to risk a situation whereby the United Nations would be unprepared to fulfil its obligations should consignments arrive before the full deployment of the agents, (ii) some members of the 611 Committee insisted upon the full deployment of the inspectors before the contract approval process; and (iii) the time between the deployment and the arrival of the first consignment of supplies was used to liaise with local Iraqi authorities and to devise procedures and modalities for the processing of consignments.*

12. OIOS is of the view that with prudent planning, the idle time and consequent expenditure amounting to approximately \$1.92 million could have been significantly reduced.

### **B. Need for additional 10 inspectors – not properly determined**

13. The Auditor also noted that when the new entry port was opened, the total value of authorized imports remained at \$1.32 billion. The total volume of goods expected to enter Iraq remained at about the same level, but the goods now entered through four instead of the existing three entry points. Under the circumstances, the Auditor raised the issue as to why no consideration was given to relocating the existing agents.

14. *OIP informed us that: (i) the number of agents per site was based upon two independent customs experts' reports; and (ii) had the Auditor examined the workload of the agents and need to provide 24 hour coverage, he would have learnt that it was 'not possible to relocate at that time'.*

15. Our further review showed that the customs expert had recommended nine additional agents on the basis of 2 inspectors per shift and 3 shifts per day and on the assumption of a five-day working week. Since time off is the responsibility of Lloyd's, in our view, the expert's assumption of a five-day working week was erroneous or irrelevant. The number of agents required should have been simply determined on the basis of the number of inspectors per shift and the number of shifts per day. On this basis, only six additional agents and a supervisor would have been required for the new site.

**C. Extensions of contract could have been avoided and significant amount of costs saved**

16. As will be noted from the table in paragraph 9 above, the application for the first extension of the contract was made to PD in May 1997, less than a month before the contract was due to expire. The requests for the third and fourth extensions were also made to PD when the contract period was about to expire.

17. Two months after the first extension came into effect, the DPA requested PD in August 1997 to negotiate with Lloyd's for the supply of the 10 additional agents with effect from September 1997. As it turned out, Lloyd's was only prepared to supply the additional agents at a cost acceptable to the Organization provided the contract period was extended. Hence, while contracting for the supply of the 10 additional agents, the Organization had to agree to the second extension of three months.

18. In recommending the approval of all the first four contract extensions, the HCC recommended that competitive price solicitation be sought if the services of the contractor were required for further periods.

19. The ASG, OCSS in approving the recommendation of the HCC for the second extension, referred to the HCC's recommendation which stated "in the event further extensions of these contracts are anticipated, PTD and DPA explore possibilities of their re-bid" and clearly directed that "This must be done in connection with any further extension" (emphasis added).

20. Soon after the second contract extension was approved, PD requested DPA to submit technical requirements/statement so that it can proceed with the bidding process as required by the UN procurement regulations and procedures. There were uncertainties associated with continuation of the programme, and there was also a need to maintain the service continuously due to the steady inflow of goods. Notwithstanding such constraints, it appears that both DPA and subsequently OIP did not heed the directive of ASG, OCSS and the HCC and take reasonable action to support PD's effort to call for fresh bidding.

21. The fourth extension of contract from 1 July 1998 to 31 December 1998, which included the provision of 12 additional agents and additional equipment and facilities, was for an amount of \$7.75 million. Lloyd's had in fact submitted its proposals for this extension on 27 January 1998. However, the request to extend the contract was not submitted to PD until 27 May (one month before the expiration of the contract). Although this left very little time for PD to effectively negotiate with the contractor, it managed to reduce the overall request of the contractor by approximately \$1 million.

22. *OIP has stated that it was deemed reasonable to recommend an extension of Lloyd's contract without seeking rebids because: (i) of the short duration (180 days) of each phase of the programme; (ii) the time it takes for a rebidding exercise; (iii) the satisfactory nature of the contractor's services; and (iv) the need to ensure continuity and stability in a politically fragile environment.*

23. It appears that the contractor was fully aware that the Organization was unprepared or unwilling to undertake fresh bidding for the service. Negotiations with Lloyd's were always conducted just before the expiry of the contract. The HCC was also not provided adequate time to consider the proposals for extensions and had to practically rubber stamp the proposals as it had to deal with a 'fait accompli' situation. Consequently the Organization's leverage to negotiate the most favourable terms for the service was seriously jeopardized and the procurement regulations and procedures were in substance not complied with.

24. The original contract rate of \$770 per agent day for the supply of 32 Agents was justified by the contractor on the basis of the need to recover the high initial fixed costs over a short contract period. Lloyd's also cited high initial costs in asking for higher rates for the supply of additional agents. It would therefore be reasonable to presume that Lloyd's would have recovered most of the fixed costs during the original contract term, and the burden of fixed costs for the 32 agents would have been only marginal during the extended periods of the contract. However, there is no evidence that any attempt was made either by DPA or PD to have the per agent day charges reduced for the extended contract periods.

25. ASG, OCSS has stated that *"due to the very limited time provided for the negotiations and the highly sensitive nature of the contract, management believes that any effort to reduce costs further would have entailed an unacceptable risk of a break of service. Accordingly under the circumstances, management believes that the action taken by PD was appropriate and constituted the best course of action available to it at the time"*. PD also noted the uncooperative position of Lloyd's during its negotiation efforts.

#### **D. Possible overpayment to Lloyd's of about \$1.38 million**

##### **(a) Deficiencies in certification of Lloyd's invoices**

26. Under the contract, the UN reserved the right to inspect and test all services performed by the contractor to the extent practicable, at all reasonable places and times including site visits. The Auditor noted that although UNOHCI and the Multi Disciplinary Observation Unit (MDOU) had meetings with Lloyd's agents or visited the sites where the agents were deployed, they were not delegated the responsibility to monitor or verify whether Lloyd's agents were deployed and in fact provided the services as contracted.

27. The Auditor noted that Lloyd's invoices were received, certified and approved by the DPA and subsequently by OIP without any on site verification or inspection reports. As this was considered to be a serious internal control weakness, the Auditor recommended that MDOU be assigned the responsibility for inspecting and reporting on the deployment and performance of Lloyd's agents.

28. The Humanitarian Coordinator in Iraq agreed with the Auditor's recommendation and forwarded the observation to OIP for comments and direction.

29. In its response dated 23 March 1998, OIP stated that: (a) Lloyd's weekly report to OIP showed the number of agents arriving in and departing from Iraq; (b) based upon Lloyd's report, it was able to identify at any time the number of inspectors on site; and (c) if

there were instances in which the attendance of Lloyd's personnel was in question, his office would welcome receiving any relevant and factual information to that effect.

30. OIP also did not agree with the Auditor's recommendation on the grounds that: (i) the inspection and verification of Lloyd's services was not within the terms of reference of MDOU; (ii) it was not sound management practice or conducive to the operation to utilize the time of the MDOU in such an exercise; and (iii) whether Lloyd's is providing satisfactory service comes from the suppliers and the Permanent Missions to the United Nations. When any of the suppliers or the Missions believe that Lloyd's has not carried out its duties satisfactorily, they very quickly contact OIP to make this known.

**(b) Shortfall in the number of agents deployed - possible overpayment of more than \$500,000.**

31. On 23 March 1998, the Auditor issued another observation on the subject. A review of attendance and duty registers provided by Lloyd's representatives in Iraq showed that during the period February 1997 to January 1998 there was a shortfall in the deployment of Lloyd's agents at the designated sites by a total of 951 agent days. Based upon this finding and the lowest agent day rate of \$529, the Auditor concluded that Lloyd's was overpaid a total of \$503,079.

**(c) OIP's response to audit observations**

32. As the Lloyd's contract was managed by OIP, the CAO of UNOHCI forwarded the audit observations immediately to OIP for its response and action. As no responses were received, the Auditor issued reminders up to July 1998. In February 1999, OIP informed us that the audit observation was not received and that it was not aware of the observation until its attention was drawn to it in January 1999.

33. OIP responded in February 1999 that the issue of overpayment was being reviewed with the contractor. OIP had forwarded the Auditor's observations to Lloyd's for comments.

**(d) Lloyd's response to audit observations on possible overpayments**

34. Lloyd's, in its reply to OIP, contended that the records provided to the Auditor by Lloyd's team leaders in Iraq were planning documents and not attendance records. Lloyd's also claimed that time sheets copied to the UN supported each invoice and that there was therefore no overcharge.

**(e) Further audit review of Lloyd's response on overpayment and audit conclusion**

35. Our review of the time sheets supplied by Lloyd's and the respective invoices showed that the travel time of agents between the designated sites and Amman in Jordan was counted as if the agents were on site and active duty. This was the main reason for the shortfall in the number of agents on site.

36. In OIOS's view, based upon the contract, travel time is the responsibility of Lloyd's and not the UN. Lloyd's was required to provide the services at the designated sites on a twenty-four hour and seven-day basis.

37. Based on the pattern for the period from December 1996 to January 1998, OIOS estimates that during the period February 1998 to January 1999 Lloyd's could have included approximately 1,800 travel days in the invoices submitted to the UN. Calculated at a rate of \$770 per agent day, the UN would have been over-invoiced a total of approximately \$1.38 million.

38. *OIP, in its response to the audit findings that Lloyd's had over invoiced, has stated that "As indicated during our meeting and as confirmed in DPA's response, while the contract does not specifically include payment of travel time, it was DPA's understanding that the term "on-site" did not imply physical presence only at the entry points, but rather also included travel time of agents from one site to another or between border crossings and the sites. This understanding was affirmed by practice of certification and payment of Lloyd's invoices, including travel time, first by DPA and then by OIP. We are of the view, therefore, that we do not have any grounds to recover funds from Lloyd's register".*

39. In OIOS view, the contract was for the provision of inspection agents on site and did not include travel time. DPA and OIP did not properly apply the provisions of the contract in reviewing and approving Lloyd's invoices for payment.

40. OIP has stated that OLA's verbal advice has been sought with respect to the status of the payments made to Lloyd's and the possible consequences that may result if action is taken to recover the overpayment from Lloyd's. In OIOS view, OIP should obtain the written advice of OLA and determine the course of action that should be taken with respect to the possible overpayment to Lloyd's.

#### **E. Other deficiencies in contractor's performance**

41. In addition to the possible overpayment, the Auditor also reported that the verification of documents indicated the following deficiencies in the agents' inspection procedures: (i) the weight of bulk cargo was authenticated on the basis of suppliers' manifests without independent verification. The Government of Iraq had complained that there were short supplies of such cargo; (ii) independent tests were not performed to determine the quality of medicines and vaccines supplied; and (iii) there was an inordinate delay in obtaining results of samples taken from consignments and it was noted that the agents authenticated and released supplies for distribution before reviewing such sample results. Finally, the UN observers had reported that certain goods supplied were found to be unfit for human consumption.

42. OIP has stated that the deficiencies in the management of the contract and the performance of the contractor have been noted and that OIP will take the appropriate corrective action in managing a similar contract with a different contractor, which became effective in February 1999.

## Recommendations

### 43. OIOS recommends that OIP :

- (i) Take action with respect to the possible overpayments made to Lloyd's based upon the written advice of the Office of Legal Affairs (AP 1998/17/11);
- (ii) Establish clear procedures and delegate responsibilities to on-site United Nations units or personnel for the monitoring and review of the services rendered by the new contractor (AP1998/17/12);
- (iii) Ensure that the contractor's claims and invoices are verified independently against services provided on-site before certifying them for payment (AP1998/17/13); and
- (iv) Keep under constant review the relative workload of the inspection agents, so as to ensure that the number of inspection agents deployed does not exceed OIP's needs (AP1998/17/14).

## IV. ACKNOWLEDGEMENT

44. We would like to record our appreciation for the help and cooperation rendered by UNOCHI, OIP, DPA and PD during the execution of this audit and the preparation of the report.



Esther Stern  
Director

Audit and Management Consulting Division/OIOS